Transnationals

New Independent States Investment Profile, pg. 2

INVESTMENT IN EASTERN EUROPE COULD REACH $50 BILLION IN 90s

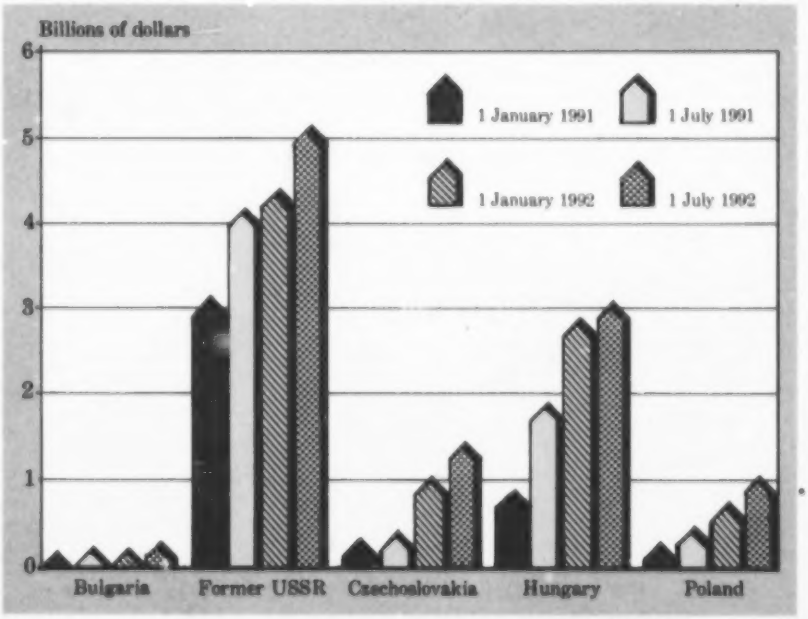
If the recent upsurge in investments into Central and Eastern Europe continues, cumulative flows to the region could exceed $50 billion by the end of the decade. This would mean a fivefold increase in regional inflows in the next six years.

In the first six months of 1992, the number of registered joint ventures and wholly-owned affiliates in the region grew by 50 per cent, to reach a total of 46,688. Cumulative foreign direct investment now totals some $11.7 billion, of which the New Independent States and Hungary account for 80 per cent.

Regional investment growth is highly uneven. Czechoslovakia, Hungary and Poland have seen the most dramatic jump in inflows in the last two years, while Albania, Bulgaria and Romania lag behind. This reflects differences in the liberalization of foreign direct investment regimes, in the success of economic, political and institutional reforms and in locational advantages.

The former Soviet Union accounts for over a half of the cumulative regional investment. But the New Independent States' singular position of setting up new countries while undertaking economic reform separates their investment experiences from that of their neighbours. ■

Cumulative Foreign Direct Investments in Central and Eastern Europe, 1991-1992



Small Transnationals: No Less than Larger Ones

In laying out the red carpet for transnational investors, governments are concentrating on big firms with big names. Smaller, less known firms may deserve similar attention. Small- and medium-sized transnationals, a recent TCMD survey finds, may have significant developmental potential.

Foreign affiliates of small firms generally produce more value-added per unit of input than large TNCs. Moreover, they are twice as labour-intensive. This is in part because they operate in traditional labour-intensive industries and in part because they tend to use labour-intensive technologies, often at the urging of local joint-venture partners.

Small transnationals, the survey shows, are also willing to transfer state-of-the-art technologies to affiliates in developing countries. Small firms are a prime source of new technologies; in some indus-

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New Independent States Inherit the Soviet Legacy

Since 1987, the former Soviet Union has received more than half of all regional inflows. With the Soviet break-up in December 1991, the New Independent States inherited $5.7 billion in investment stock.

Every year from 1987 to 1991, the Soviet Union received an average of $1 billion in foreign direct investment. In 1990, the total number of foreign registered affiliates and joint ventures was 2,050. In 1991, that number more than doubled. By September, 2,450 new investment arrangements had been signed, amounting to over $2.5 billion in foreign capital.

By 1990, three quarters of all investment made in the former Soviet Union was in Russia. Moscow and St. Petersburg accounted for about 90 per cent. While overall investment in the former Soviet Union doubled in that year, it almost tripled in St. Petersburg and its surrounding region.

Ukraine is the next largest host. The Baltic States, Kazakhstan and Kyrgyzstan also have received significant amounts of new investment. This year, for example, Chevron and Elf-Aquitaine announced major petroleum projects in Kazakhstan. Foreign capital has flowed into the other former republics as well, but the increase has been less marked.

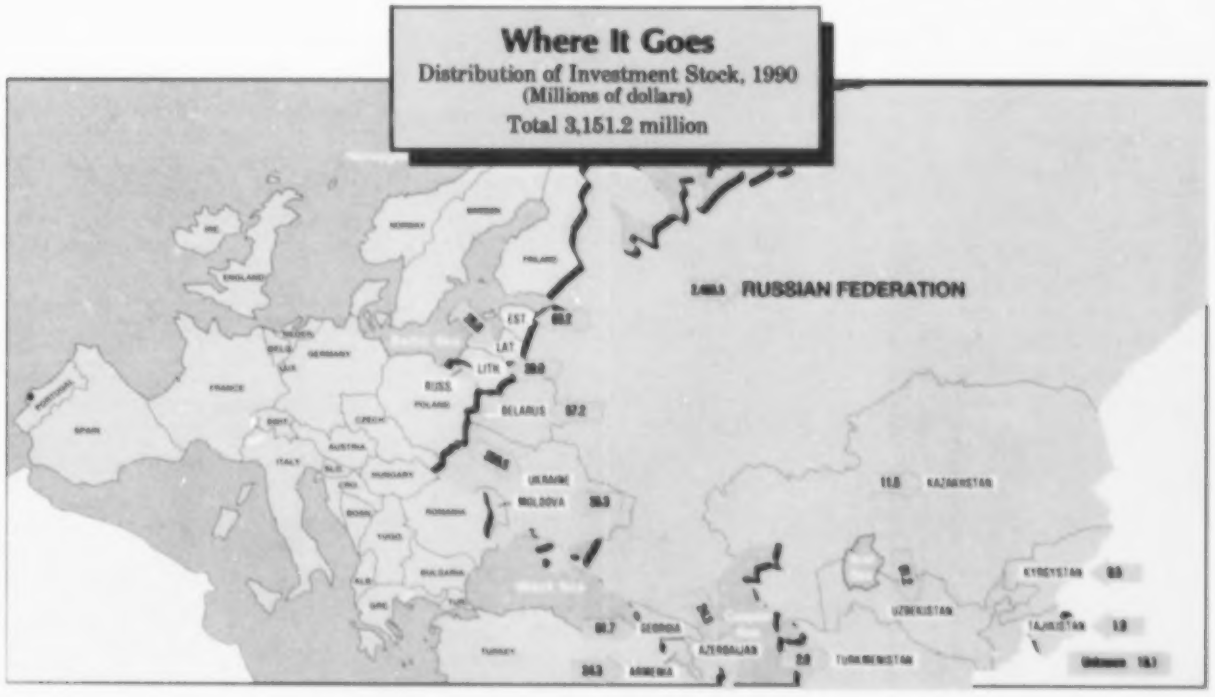
The United States is the largest investor, followed by Finland, Germany and Italy. Developing countries account for one tenth of investments.

The United States Is Largest Investor

By 1990, the United States had become the largest investor in the former Soviet Union, with investment stock of $360 million. Finland followed with $357 million, Germany with $346 million and Italy with $290 million.

However, the largest foreign affiliates in the New Independent States are not those of United States firms. The largest affiliate belongs to a Finnish company, Agroenero. With more than 250 million roubles in total capital, its affiliate produces electrical equipment and motor vehicles. A Yugoslav wood-products affiliate, a Bulgarian chemicals firm, a Taiwanese firm, and L'Oréal, the French cosmetics company, follow. The Carlisle Corporation owns the largest United States affiliate, which produces rubber and plastics.

The Central and East Europeans also have sizeable investments in the New Independent States. Bulgaria, with over a half



($151.3 million) of this total, is the largest investor.

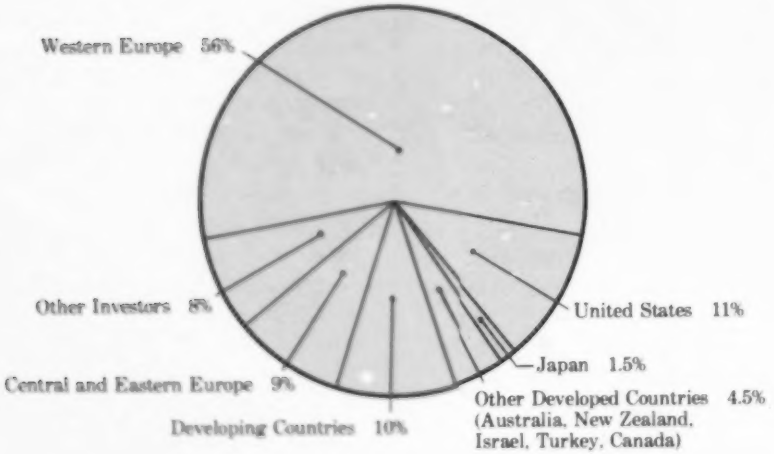
Manufacturing Gets the Largest Share

Most investments go into manufacturing, of which chemicals, electrical equipment, machinery, office equipment and computers, food, and rubber and plastics receive the bulk. The services sector follows in importance.

In 1989, investments in agriculture jumped dramatically from $6 million to $42 million. Among other things, Western food transnationals like McDonald's and PepsiCo started major fast-food chains and food-processing plants. In 1990, agriculture accounted for 43 per cent of all foreign investment in the primary sector. Resource extraction accounted for 15 per cent. Fishing lost its earlier importance.

Where It Comes From

Geographical Distribution of FDI Stock, 1990
(Millions of dollars)
Total $3,152 million



Despite the rich mineral resources of the former Soviet Union, only 3 per cent of all investment was in the primary sector. Almost all that investment was in fishing, centring on the export of caviar and salmon to Europe and North America. Investment in agriculture was small.

Investment in resource extraction has been negligible, despite vast oil and natural-resource deposits. Restrictions on foreign capital in that sector are largely responsible. These are now being relaxed. Second, transnationals have had to renegotiate with the New Independent States all investment agreements concluded with the former Soviet Union.

In 1990, one third of all investments were in services, catering to a host of new businesses and potential foreign investors. Finnair and another Finnish business-services firm were among the four largest services affiliates, as were a United States and a United Kingdom construction firm. Italy and Germany owned the biggest foreign bank affiliates.

An Upswing in Investments from East Asia

Developing countries account for one tenth of all investments in the New Independent States, reflecting close political and economic ties with the former Soviet Union. The Democratic People's Republic of Korea accounted for about $27.5 million, China and India for over $20 million each.

Russian and Ukrainian enterprises have begun to make sizeable investments in the Baltics and Western Europe.

Most dramatic is the recent influx from the Asian newly industrialized countries. Before the opening of the Soviet economy in 1989, there was practically no investment from this region. In 1990, Taiwan Province of China invested $30 million in the Commonwealth, becoming the largest developing-area investor. Hong Kong and Indonesia also made sizeable investments.

But Outflows Drop

Much as the New Independent States have inherited the Soviet Union's inward investment stock, so, too, have they become heirs to all investments abroad. In 1990 those amounted to about $700 million dollars in developed countries, primarily in the form of state-owned trading companies selling vehicles, agricultural equipment, machine tools and financial services. Such companies sold about 8 billion dollars worth of goods in developed countries in 1990.

In the late 1980s annual outflows soared, reaching $56 million in 1989. In the 1990s they plummeted, due to the political turmoil and the break-up of the Soviet Union. Now, however, a number of Russian and Ukrainian enterprises have begun to make sizeable investments in the Baltics and in some other New Independent States. They are also investing in Western Europe to preserve links with earlier suppliers and customers. ■

Brazilian Affiliates: Adjusting for Survival

Brazilian affiliates of transnational corporations have undergone significant adjustments since 1990, say executives of fifty-five of the largest one hundred affiliates located in the country. They were responding to a recent TCMD survey on the role of transnational corporations in industrial restructuring in Brazil. Their firms account for 40 per cent of all local sales of manufactures by foreign affiliates.

Nonetheless, foreign affiliates were responsible for much of Brazil's annual 8.4 per cent growth in exports over the 1980s—a rate more than twice that of world trade. They also helped to increase exports of manufactures—steel, aluminium, petrochemicals, pulp and paper, thereby decreasing the traditional dependence on exports of food.

Foreign affiliates led much of Brazil's annual 8.4 per cent growth in exports over the 1980s.

Investment Decline

Brazil, the largest economy in Latin America, received about a half of all foreign direct investment into the region until the debt crisis hit in the early 1980s. European companies accounted for 50 per cent of all foreign investment stock in 1990, and North American firms for 33 per cent. This contrasts with the rest of Latin America, where the United States is the primary investor. Most investments are in manufacturing—machinery, consumer durables, transport, chemicals and petrochemicals.

Brazil now receives just a fifth of regional inflows. Public-sector financial crises, inflation, high domestic interest rates and balance-of-payments problems over the last decade hit foreign affiliates in Brazil particularly hard. Production fell about one per cent per year over the decade of the 1980s.

Crisis Forces Adjustment

Recession and the worsening of micro-economic conditions forced them to readjust. And trade liberalization was an important complementary factor, firms say, in pushing them to step up their international competitiveness.

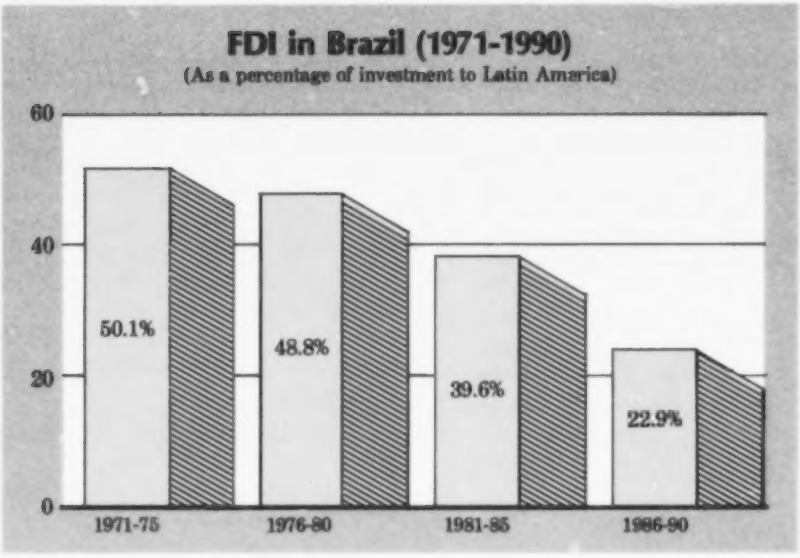
Since 1990, the Government has made every effort to undo four decades of import-substitution and open Brazil's protected economy. It has cut state spending, eased foreign investment rules and liberalized trade. Import tariffs on imported vehicles, for instance, have been reduced from 85 to 50 per cent and are slated to reach 35 per cent by 1994. Major state enterprises are being privatized. Corporate taxes, including those on foreign investors, are being improved. The country has also entered into the MERCOSUR treaty, committing itself to the establishment of a free-trade area with Argentina, Paraguay and Uruguay by 1995.

Firms are focusing on improving product quality, reducing production costs and improving productivity. But, above all, they are concentrating on modernizing management techniques and corporate organization. Given the

What Will Be Your Growth Strategy in the Next Few Years?

(Percentage response)

To increase domestic sales	22%
To boost domestic sales, while increasing exports	58%
To focus equally on domestic sales and exports	8%
To boost exports, while increasing domestic sales	10%
To increase exports	2%



recession and the resulting shortage of finance, that is the quickest and easiest approach to streamlining operations..

Technological Gap Is Still Large . . .

But the current adjustment is not yet a fundamental restructuring. Firms say they are only prepared to invest in plant expansion and in major technological upgrading, like "flexible automation", if macroeconomic stability is regained.

As a result, and in spite of important improvements already achieved during the current adjustment, Brazilian affiliates still lag behind international standards in productivity and automation. Sixty per cent of the affiliates surveyed feel their equipment is not as modern as that found abroad and more than half feel that local labour is technologically not up to the mark.

Future Prospects

Under satisfactory conditions, firms will resume large investments in the 1990s, expanding plants and focusing on intense technological upgrading and cost reduction. They will seek to increase exports, but will continue to be attracted mainly by the large and traditionally very profitable domestic market. This willingness to invest despite the present hard times, they say, is promoted by their already existing investment, which, if sold under current circumstances, would lead to heavy losses. Sunk costs make it imperative for transnationals to keep investing so as to preserve or increase local market share.

The recently concluded regional MERCOSUR Treaty is not expected to have a major impact on investments.

The trade liberalization programme is likely to help. But the recently concluded regional MERCOSUR Treaty is not expected to have a major impact on investment inflows. However, many firms expect large increases in trade with Argentina, Paraguay and Uruguay.

The survey is part of a TCMD project examining the role of transnational corporations in industrial restructuring in Brazil, Chile, Colombia and Mexico. ■

What Are Your Key Objectives in Technological Upgrading Over the Next Few Years?

(Percentage response)

	Very important	Important	Not so important
To introduce new products and modify existing ones	39	45	16
To lower manufacturing costs	69	29	2
To lower the wage/sales ratio	6	65	29
To improve product quality	51	35	14

Small Transnationals

(Continued from page 1)

tries, such as biotechnology and datamatics, they are in the vanguard of technology development.

national investments were in manufacturing. United-States investments went primarily into petroleum-related industries.

Despite their size, small firms command, on average, a 30 per cent market share for their product at home and a 15 per cent share abroad. That is because they often operate in niche industries. In host developing countries, small firms sometimes command a slightly higher share than the affiliates of large transnationals.

The affiliates of small enterprises are more export-intensive than those of large firms.

Finally, the affiliates of small enterprises are more export-intensive than the affiliates of large firms. More than a quarter of all the small-enterprise affiliates surveyed export more than 80 per cent of their output. The corresponding figure for large firms is 17 per cent.

Foreign Investment by Japanese Small Transnationals

(Global percentage distribution)

	1980-1985	1991
Developed countries	61%	49.9%
Developing countries	39%	50.1%

Growing Small-Firm Investments in Developing Countries

The survey defines a small- or medium-sized transnational as a firm with less than 500 employees in its home country and at least one affiliate abroad. Small firms account for about half of all Japanese transnationals and about a quarter of the United States total.

During the 1980s, small Japanese and United States transnationals, on average, made increasingly larger investments in developing countries. European firms, on the other hand, tended to stick to developed-country markets. In the last five years, over 42 per cent of Japanese small transnational investments were in manufacturing. United-States investments went primarily into petroleum-related industries.

Despite their size, small firms command, on average, a 30 per cent market share for their product at home and a 15 per cent share abroad. That is because they often operate in niche industries. In host developing countries, small firms sometimes command a slightly higher share than the affiliates of large transnationals.

A Hand from Government

While size can be an advantage, it is often a handicap to small firms. A shortage of finance, managerial and information resources, or inadequate host-country infrastructure often impedes small firms in setting up production abroad.

Home and host countries are setting up policies and incentives to encourage small firms to transnationalize. Japan offers its small firms low-interest loans. The United Kingdom, Sweden and Belgium offer investment guarantees. Public institutions in the United States, Denmark and Germany invest in joint ventures between small firms and local partners in developing countries. Many countries also offer training, provide information and legal services and help identify local partners.

Among developing countries, only Mexico and the Republic of Korea have programmes designed specifically to attract small- and medium-sized transnationals. Given the growing economic importance of these firms, the survey advises, they should receive more governmental attention.

TCMD Survey

The survey questionnaire was sent to 3,315 developed-country small transnationals and to 1,257 of their affiliates. Questionnaires were also sent to 862 affiliates of large transnationals and 460 indigenous firms, to compare development impacts. In addition, interviews were conducted with officials of developed-country public institutes that support foreign direct investment by small enterprises, in order to evaluate the effects of their policies on investments. ■

Why Do Small Firms Transnationalize?

Expected growth in foreign market	50%
Strengthened competitive position	28%
Access to third-country markets	25%
Gathering of market information	21%

TRANSNATIONAL CORPORATIONS

A new journal of the Transnational Corporations and Management Division of the United Nations Department of Economic and Social Development. **Transnational Corporations** is a triennial refereed journal with a focus on the political economy of transnational corporations.

Appearing in the next issue of
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Robert Z. Lawrence	Why is foreign direct investment in Japan so low?
Stephen Young and Neil Hood	Transnational corporations and policy dilemmas: the problems of the machine-tool industry in the United Kingdom
Silvia B. Sagari	United States foreign direct investment in the banking industry
Katherine Marton	Foreign direct investment in Hungary (research note)
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— **Edward M. Graham**, Senior Fellow, Institute for International Economics, Washington, D.C.

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Taking a Fresh Look at Intellectual Property

Transnational corporations and developed-country governments have long pushed developing and formerly centrally-planned countries to legislate stricter protection for intellectual property. Now, these countries may have a chance to capitalize on their own intellectual property and to ask a price for it.

Marketable Expertise

Developing and formerly centrally-planned countries have generally opposed patents, copyrights and trademarks because they grant a few innovating individuals and firms monopoly over new technologies and allow high prices to be charged for resulting products. Restricting access to new technologies and products, it was felt, hinders economic development by raising costs. Less industrialized countries also have little stake in protecting intellectual property, since most technologies are generated in developed countries.

But now some developing areas are beginning to produce intellectual expertise valuable to transnational companies. India, the Republic of Korea and Taiwan Province of China, for example, are innovative in software, Brazil in electronics and Cuba in health care. At the same time, the break-up of the Soviet Union has opened the door for the Eastern European states to sell some of the world's most advanced technological research and scientific manpower abroad.

Transnational companies are establishing more partnerships in those countries, drawing heavily on local scientific expertise.

Traditional Know-How

A further dimension of companies' new interest in the intellectual property of developing countries does not involve high technology, but, rather, the traditional medicinal know-how of indigenous peoples.

With the new interest in biotechnology, companies are going to great lengths to develop genetically engineered, ecologically safe products. At the forefront are pharmaceutical firms seeking to develop medicines that use the body's natural metabolism to combat illness. Many of the ingredients used in such medicines are found in tropical plants that grow in developing countries. According to an article in a recent issue of the *Harvard International Law Journal*, medicinal plants are estimated to account for about $45 billion of the $105 billion OECD pharmaceuticals market. The herbal knowledge of traditional medicine-men has helped companies to isolate healing compounds, saving time, money, and research.

Some developing countries are beginning to produce intellectual expertise valuable to transnational companies—India in software, Brazil in electronics and Cuba in health care.

Fifteen developing countries have set up a gene-bank which foreign companies can use for a fee.

New Opportunities

In many cases, foreign companies have been able to acquire local expertise or medicinal know-how for a price far below what they would pay if it was legally protected. That is because the regulatory frameworks for intellectual-property protection are weak in many developing and formerly centrally-planned countries. Often there are no facilities where individuals can file patent requests, and government officials lack the know-how to evaluate them. Only a handful of those countries belong to the World Intellectual Property Organization (WIPO). The patent application process can also be prohibitively expensive, especially in the case of pharmaceuticals, requiring tests that may span a number of years and cost millions of dollars.

Nonetheless, those countries have begun to recognize their opportunities. Brazil is evaluating the technological and commercial potential of local inventions and making patent information available to small and medium-sized enterprises. In Costa Rica, a non-profit organization will collaborate with Merck, the German drug company, in looking for medicinal-plant compounds and will receive revenues from the marketed drug. Fifteen developing countries have set up a gene-bank of all their herbs and medicinal plants which foreign companies can use for a fee.

TCMD is providing assistance to countries in Latin America and the Baltic region on legal issues relating to intellectual property protection. It is also looking into the question of how intellectual property protection, or the lack of it, affects the flow of foreign direct investment into developing countries. ■

Getting Ahead: What Shape or Form?

The successful transnational of the 1990s? Most likely a company with many corporate centres, affiliates equal to headquarters in decision-making, and management control exercised through unified corporate culture and teamwork rather than hierarchic command.

So predicts a new anthology, *Transnational Corporations and Business Strategy*. Published by TCMD, it presents some groundbreaking research on how transnational companies formulate competitive strategies, how they put these into effect by changing corporate structure, and how both strategy and organization have changed over time. The literature also outlines, for transnational companies, "best" strategies and organizational structures for particular industries or economic situations.

Greater Focus on Subsidiaries

When firms first transnationalized, foreign operations were secondary to home markets. Headquarters set competitive strategy and controlled investments and technology, and affiliates acted only on central command. As global economic integration accelerated, affiliates, best positioned to determine foreign market needs and draw upon foreign assets, began increasingly to be called upon in designing overall corporate strategy.

Should that trend continue, the transnational firm is likely to become an assemblage of horizontally related units—a "heterarchy", as the anthology terms it. Individual subsidiaries will become coordinating centres for specific firm activities or lines of business. For example, Atlas Copco, a Swedish company, runs its air power divisions from Belgium, while its other divisions are headquartered in Sweden.

Transnational firms' multinationality, the anthology says, will become their key competitive weapon. Earlier, firms had banked on innate advantages in designing competitive strategies, such as the ownership of a unique technology or product. Now, however, access to distribution channels, brand name, international experience and finance are becoming equally important in determining international competitiveness.

Informal Structures

The way a company is organized does influence its competitive success. But seeking an ideal international structure through repeated corporate overhauls may be counter-productive, the anthology says. Informal structures may be more effective. Firms should focus on changing corporate behaviour through altering reward systems and articulating new goals and values. ■

Evolving Corporate Firms

Ethnocentric firm — Foreign business marginal, tight headquarters control of affiliates, internationalization conducted through new investments.

Polycentric firm — Foreign business more dominant, affiliates operationally independent, internationalization conducted through acquisitions.

Heterarchy — Business is seen as global, affiliates become intra-firm coordinating centres on par with headquarters.

Transnational Corporations and Business Strategy, edited by Donald J. Lecraw and Allen J. Morrison, is the fourth in a twenty-volume *United Nations Library on Transnational Corporations* being prepared by TCMD. The *Library* is published by Routledge, London.

The Transnational Corporations and Management Division is one of eight Divisions in the United Nations Department of Economic and Social Development. Under the guidance of the Commission on Transnational Corporations, an intergovernmental subsidiary organ of the United Nations Economic and Social Council, TCMD seeks to further understanding of the nature of transnational corporations; to secure effective international agreements; and to strengthen the negotiating capacity of host countries, in particular the developing countries.

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Editor: Khalil Hamdani.

Associate Editor: Premila Nazareth, Assistant Editor: Louise Rankin.

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2 United Nations Plaza
New York, NY 10017, USA